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RHEBAA/DEPT OF ENERGY WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 ALGIERS 000904

SIPDIS

E.O. 12958: DECL: 08/11/2018
TAGS: [EPET](#) [ETRD](#) [ECON](#) [PREL](#) [MO](#) [AG](#)
SUBJECT: ALGERIA HAS NO GAS TO SPARE

REF: A. RABAT 735
 [1](#)B. ALGIERS 254
 [1](#)C. 07 ALGIERS 1783
 [1](#)D. ALGIERS 825
 [1](#)E. ALGIERS 626
 [1](#)F. ALGIERS 837

Classified By: CDA, a.i. Thomas F. Daughton; reasons
1.4 (b, d and e).

[1](#)1. (C) SUMMARY. Despite speculation in the press and pleas from Moroccan officials regarding new sales of Algerian natural gas to Morocco (ref A), as we have previously reported (refs B, C), Algeria will likely have little or no excess gas export capacity starting in 2009, and might face an export capacity deficit for the following five years. Algeria's new oil and gas development bid round (ref D) appears to be structured partly to address lagging gas production, but development of those fields will not help in the near term. While industry experts agree that Algeria's long-term gas potential is promising, tough choices will have to be made in the meantime by the hydrocarbons parastatal, Sonatrach. Those choices could include sacrificing production of high-value petroleum condensates; reducing the volume of spot-market LNG sales in order to meet less profitable, long-term contracts; and buying gas from other sources, including Gazprom, to sell to its existing customers. Accordingly, new gas supply contracts seem unlikely unless the Ministry of Energy is successful in its stated goal of converting Sonatrach's existing 20-year contracts to more flexible and profitable four- or five-year agreements (ref E). The gas deficit trend should reverse after five years, but the push to deliver gas in the near term may damage oil infrastructure, and the spectre of gas shortfalls could tarnish Algeria's current image in the EU as an alternative to Russian supply (ref F), even as Gazprom is eyeing a role for itself in Algeria's supply chain. END SUMMARY.

MOROCCO WANTS MORE

[1](#)2. (C) In recent weeks, regional and international news outlets have reported that Morocco wants to negotiate new gas deals with Algeria. Moroccan officials have also indicated their dismay at a perceived Algerian unwillingness to negotiate such sales, since they believe that Algeria

possesses an energy surplus (ref A). Sonatrach's VP for downstream activities, Abdelhafidh Feghouli, confirmed to the Algerian Arabic-language daily El Khabar on July 20 that Morocco expressed interest in taking more gas from the Mahgreb-Europe Gasline (GME), which pipes gas from Hassi R'Mel, Algeria, through northern Morocco and across the Straits of Gibraltar to Spain at Tarifa. It is reported that Morocco currently takes some 450 million cubic meters of gas per year from the GME, in addition to accepting cash payments of transit fees in lieu of a roughly equal amount of gas to which it is entitled. Several media sources reported that Morocco discussed with Spain on July 14 the conversion of the transit fees to gas, and that it also offered to purchase an additional one billion cubic meters of Algerian gas per year from the GME (the current flow-rate is approximately 12.5 billion m3/year). Sonatrach's Feghouli was quoted as saying the issue requires negotiations involving all parties concerned, but he did not offer a timeline or commitment.

ALGERIA AIN'T GOT IT TO GIVE

13. (C) As we have previously reported (ref C), experts tell us that Algeria will have trouble meeting its existing contractual obligations for natural gas sales to Europe in the coming years, leaving little room for new gas exports. The president of BP Algeria reiterated to us on July 11 that Algeria would have a tough time increasing its current gas output of 62 billion m3/year anytime soon. He noted that the Algerians are pushing out their previous ambitious targets as

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major upstream and downstream projects remain behind schedule. Zoheir Hamedi, a former Sonatrach communications and strategy director now working for the British embassy in Algiers, was far more blunt about Algeria's gas supply problems. He told us on July 12 that Algeria faces a gas export capacity deficit starting in 2009, meaning that after accounting for the gas needed for its domestic electricity and industrial needs, Algeria will not have enough deliverable gas to meet Sonatrach's overseas contracts, mostly with Europe. Hamedi said this export capacity deficit is estimated to last five years, after which time new upstream and downstream facilities are expected to boost gas production well beyond domestic needs.

14. (C) BP Algeria's president called the Moroccan bid for more gas intriguing, noting that it is usually a wiser economic decision to sell product as close to the source as possible in order to limit transport costs and risks. He said, however, that given its current output limitations, Sonatrach would have to look carefully to determine if it could juggle its existing contracts to find an additional billion cubic meters per year of gas for Morocco. Hamedi said that he believed the Moroccan request has not yet been seriously considered within Sonatrach; it is still a policy question being debated at the Ministry of Energy. Nonetheless, as Energy Minister and OPEC President Chakib Khelil told us in May (ref E), Algeria may try to renegotiate its long-term gas contracts with Spain, Italy and others in favor of more flexible four- or five-year contracts, which could free up some volume for Morocco.

TOUGH CHOICES FOR SONATRACH

15. (C) Hamedi said that Algeria finds itself in a paradoxical situation: while the country produces more gas than oil each year, it makes far more money on its petroleum production, but it may need to reduce its oil production in order to meet its existing gas obligations. This is due to the fact that Algeria is locked into 20-year contracts for gas sales to Europe through its pipelines at prices that are currently far below market-rate. Furthermore, Hamedi said, some 40 percent of Algerian gas production is actually cycled -- it is reinjected into oil wells to boost the production of

petroleum condensates, the highest-valued of Algeria's hydrocarbons products. Hamedi said that Sonatrach engineers and strategists are mulling three immediate choices in order to meet Algeria's existing gas contract obligations: sell less gas on the highly profitable LNG spot-market and direct those volumes to its long-term customers at below-market prices; cycle less gas for condensate production, again sacrificing high profit margins, but also risking a permanent degradation to those wells; or, import gas in order to meet both its domestic consumption needs and its export obligations.

¶6. (C) Hamedi noted that the irony of Algeria importing gas when it will continue to be a major exporter becomes even stronger when considering the possible sources. He heard from former colleagues at Sonatrach recently that the company is considering buying gas from Russia in order to meet Algeria's total gas supply needs. Hamedi told us that he visited the local Gazprom offices in early August to sound them out on the idea. A Gazprom executive simply smiled when asked directly if he was talking to Sonatrach about future gas supply deals, and then noted the Russian company's interest in helping develop the Trans-Saharan Gas Pipeline project that would ultimately bring Nigerian gas to Europe through Algeria (ref B). Hamedi suggested that this may be Algeria's best alternative for an exterior source of natural gas, and that Gazprom may have the political and financial muscle to push the project through. But he admitted that it would likely not come online soon enough to address the five-year time horizon he outlined as Algeria's gas export deficit.

¶7. (C) Hamedi also suggested that Algeria's current oil and

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gas exploration and development bid round (ref D) was structured partly to address the anticipated gas export capacity deficit. In light of several upstream and downstream setbacks in 2007 (ref C), it appears that the Ministry of Energy opened more blocks for bidding in July than previously expected. Algeria's announcement of 45 blocks within 16 zones, some of which have already been partially explored and developed by Sonatrach, coupled with the prequalification of over 70 oil companies and investors to bid in the round, suggests that the Ministry was eager to fast-track gas development. Hamedi speculated that the goal was to offset the looming export capacity deficit as quickly as possible.

LONG TERM PROSPECTS BETTER

¶8. (C) BP Algeria's president remains optimistic about Algeria's long-term gas prospects. His company produces almost no oil in Algeria, and will look to expand its gas production here with the new bid round. When asked about the quality of Algeria's geology for gas development, he described the geology as mixed, with some "tight gas" deposits but "a lot of possibility." (Separately, ConocoPhillips Algeria's country manager told us that several of the blocks were projected to contain multi-trillion-cubic-meter reserves, though special techniques would likely be required to extract them.) BP's president noted several factors responsible for Algeria's lagging production goals, including delays at projects like Gassi Touil (ref C), but also a lack of human resources at Sonatrach. He said that their joint ventures are plagued by key Sonatrach positions going unfilled, forcing BP to increase its costs by filling the slots with its own employees, or paying premium wages for specialty contract engineers and analysts. Former Sonatrach official Hamedi said that Algeria should run gas export capacity surpluses beginning around 2015, assuming all goes well with the current upstream development round and with downstream delivery projects.

19. (C) Despite the assertions by Moroccan officials that Algeria is simply playing hardball in negotiations for new gas deals (ref A), Algerian officials at the Ministry of Energy and at Sonatrach must certainly be eyeing the country's production balance sheets and asking themselves if they literally have any gas to spare for their neighbor to the west. Recent overtures by the French and Germans (ref F) that seem overtly geared toward counter-balancing a Russian gas supply chokehold on Europe may be for naught, at least in the short- to mid-term, if Gazprom not only wins important stakes in Algeria's bid round but becomes a stakeholder in the Trans-Saharan Gas Pipeline or a supplier to Algeria in some other form. Long-term prospects for Algeria's gas production and delivery appear considerably rosier, but in the short term Algeria's capacity and willingness to be a stable supplier of additional gas are in serious doubt.

DAUGHTON